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TAGS: [EPET](#) [EINV](#) [ECON](#) [EC](#)
SUBJECT: GOVERNMENT OF ECUADOR WHIPSAWS OIL COMPANIES

REF: A. QUITO 293
[1](#)B. QUITO 55

Classified By: Classified by DCM Jefferson Brown. Reason: 1.4 B and D

[1](#)1. (SBU) Summary: After months of negotiations with international oil companies, the Government of Ecuador has announced that it will suspend negotiations for another six months, in an effort to migrate all agreements to risk-service contracts. This development will likely delay investment in the sector for at least a year. End summary.

Correa Suspends Oil Contract Negotiation

[1](#)2. (U) President Correa announced on April 12, while he was visiting Mexico, that negotiations to restructure contracts with international oil companies would be suspended. Correa stated that while he felt the GOE had made much progress in ongoing negotiations, he felt that it could &do better.8 In six months, after the approval of Ecuador's new constitution (which is still in draft), the government will supposedly unveil a new risk-service model contract.

[1](#)3. (U) Minister of Petroleum Chiriboga met with petroleum companies on April 14, after which he publicly reaffirmed Correa's instructions to suspend contract negotiations and develop a new model contract. He also announced that the GOE is currently preparing a new temporary contract that the companies are supposed to sign pending the preparation of the new model.

Some Negotiations Had Been Going Well, Others Not

[1](#)4. (C) Until Correa's surprise announcement, we understand that negotiations with at least two companies, Andes Petroleum and Repsol, had been going well, particularly on the economic provisions, although negotiations were continuing on legal issues (reftel a). However, negotiations with two other companies, Perenco and Petrobras, were moving more slowly. U.S.-owned City Oriente has taken a different tack and has been trying to negotiate compensation for terminating its contract.

[1](#)5. (C) On April 10, U.S.-owned Murphy Petroleum, part of the Repsol consortium, explained for us some of the key economic features of the now-suspended contract negotiations. The consortium has been paying the 99% windfall tax on petroleum revenue over \$25/barrel. The GOE negotiators had agreed to move the reference price up to \$45.50/barrel, and that any income over the new reference price would be subject to the 70% windfall tax established in the new tax law (reftel b).

The government's share of production would also change, although Murphy did not provide any specifics. The key issue, the Murphy representative said, is that the new economic provisions allowed the investors a sufficient return, and the consortium had agreed to invest \$315 million over six years to 2018. Outstanding issues included arbitration and how to credit payments made under the 99% tax. On April 16, Murphy confirmed that the negotiations had been put on hold but did not speculate about next steps.

¶6. (C) On the other hand, on April 17, ConocoPhillips told the Ambassador that its contract negotiations had already been suspended by the government before Correa's announcement, with the two sides in disagreement over the economic terms. Conoco, through its Burlington subsidiary, has minority shares in two blocks operated by Perenco. (More details on Conoco are reported septel.)

Will This Prompt More Arbitrations...

¶7. (U) Solicitor General Xavier Gariacoa publicly stated on April 16 that Correa's decision to suspend contract negotiations could increase arbitration cases against Ecuador. He said that a number of oil companies (Burlington, Andes, Perenco, Repsol, and Petrobras) had notified the government of their intent to initiate international arbitration. Gariacoa noted that the six-month cooling off period was about to expire, and speculated that some companies might seek arbitration.

¶8. (C) The U.S. oil companies in Ecuador had decided to file for arbitration even before Correa's April 12 announcement. Murphy registered its case with ICSID on April 15, but in March had already decided to proceed (reftel a). Conoco informed post on April 17 of its plans to file for arbitration, but said that it had already decided to do so before the latest announcement. City Oriente filed for arbitration in December 2006.

...and Further Delay Investment?

¶9. (C) The U.S. oil companies in Ecuador have told us that they and their partners have frozen their investment plans, City Oriente when the windfall tax was first implemented in 2006, and the others after the tax was raised to 99% in October, 2007. We assume that Petrobras has done so as well, although we have heard that Andes Petroleum, whose contract provides some relief from the windfall income tax, may be undertaking some investments.

¶10. (C) Murphy Petroleum, when it thought contract negotiations were still moving forward, explained that it would take several months after a contract were finalized to resume its investment program, noting that key equipment and skilled workers are in short supply. Even if the oil companies are willing to proceed under the new arrangements being sought by Correa, we presume it will take well over six months to reach agreement on new contracts, which suggests that new investments will not be made for at least a year.

Comment

¶11. (C) It had appeared that the government realized that it needed the foreign oil companies to renew their investment programs and was negotiating in good faith with at least some of them. Those negotiations were led by Minister Chiriboga, who apparently was blindsided by Correa's decision to raise the windfall tax in October. It appears that once again Correa has pulled the rug out from underneath him.

¶12. (C) It is not clear what prompted Correa's decision to suspend the contract negotiations, but the most likely explanation is that when Chiriboga explained the economic provisions that he had agreed to, Correa felt they were insufficient. This view was reaffirmed by Conoco's President

for Latin America, Roy Lyons, who met Chiriboga on April 16, and reported that Chiriboga told him that Correa believes the companies can pay more.

¶13. (C) Correa's decision appears to be a significant setback for reaching negotiated agreements with the oil companies and restoring the companies' investment programs in the near future. Although the U.S. companies have said that they would prefer to reach negotiated settlements than pursue arbitration, we suspect that this latest change will further weaken the companies' belief that they can reach a mutually agreeable settlement. It would not surprise us if some of the non-U.S. oil companies also initiate arbitration following this latest setback.

Jewell